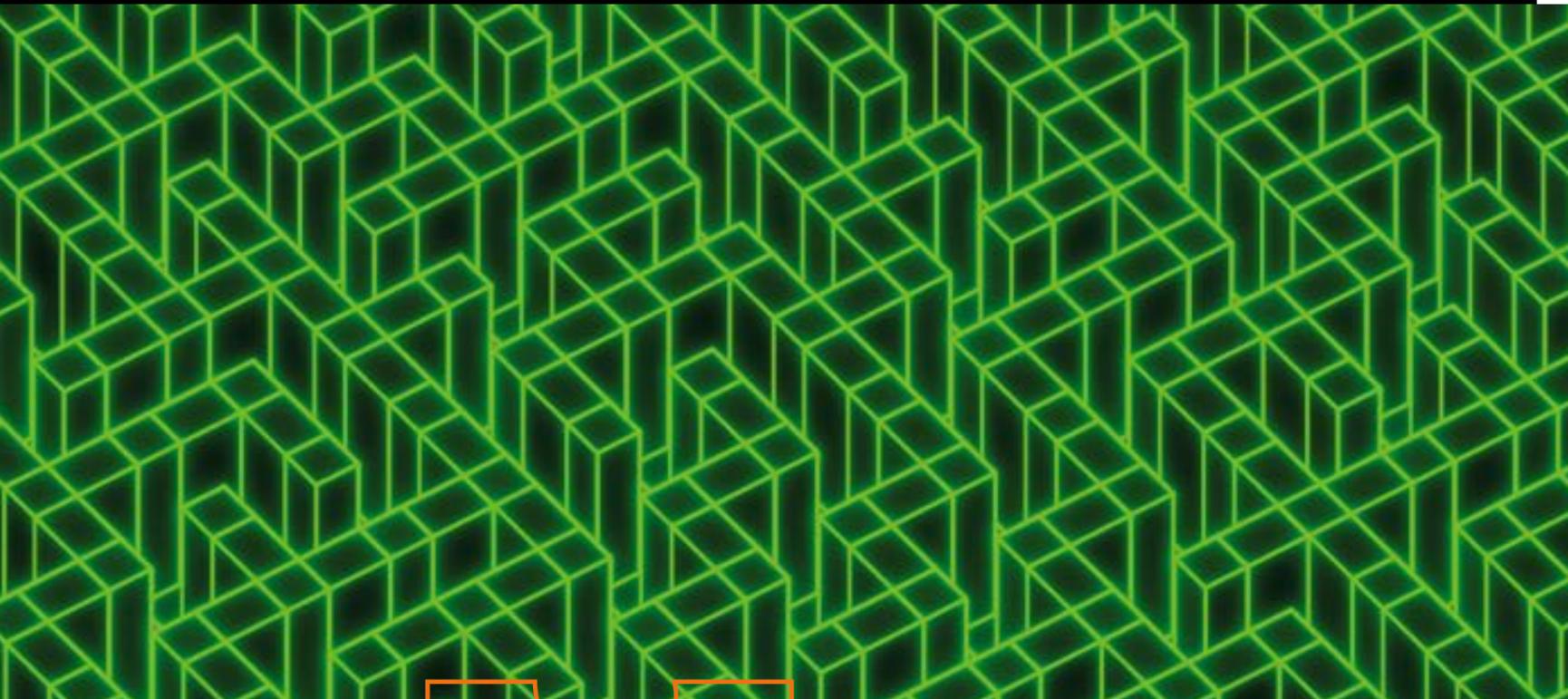


The Tax

Making Tax Digital will require businesses to implement digital links from next year, but what lessons have we learnt from phase one and how can businesses get the most out of the mandate?



Map

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Businesses are now preparing for the second phase of Making Tax Digital (MTD), but it is liable to be a far more complex and disruptive process than phase one. Businesses are approaching compliance in a variety of ways but a failure to embrace automation and look at the long-term goals could see some lose out when the mandate comes into force from April 2021.

Phase one of MTD commenced in April 2019 and saw eligible businesses required to submit their VAT Return via the HMRC Application Programme Interface (API). Phase two will see the digitalisation of the entire process. Businesses will have to put in place digital links between their source data, their MTD solution, and the HMRC API to create an end-to-end process, the aim of which is to reduce mistakes by automating the transference of data. This means manual processes such as cut or copy and paste will no longer be allowed, potentially making it more difficult to perform certain actions.

Changing Workflows

Take adjustments (fuel scale charges or bike schemes, for example), special schemes (retail, TOMS etc) and amendments and error corrections. These all require the finance team to apply a number of checks and balances and to correct the figures accordingly. Going forward these calculations must be performed without cutting or pasting in software that is digitally linked so that it will be possible to determine how and where changes were made.

Other even more complex processes, such as Partial Exemption Special Method, which sees the application of bespoke criteria, agreed in advance with HMRC, to determine the amount of recoverable input VAT, will need to be either supported by the MTD software or performed outside the process and factored back in. The latter approach does of course negate the advantages of MTD which is why, in VAT notice 700/22, HMRC emphasises that “using [MTD] software for all your calculations will reduce the risk of errors in your returns”.

Businesses were promised that MTD would help improve their internal processes, reduce the risk of error and save them time. But in its evaluation of phase one, HMRC notes that “those continuing to use spreadsheets with bridging products [found] the transition more difficult” and reported “that the software was not meeting [their] expectations or providing tangible benefits”. A Chartered Institute of Taxation (CIOT) and Association of Taxation Technicians (ATT) joint survey earlier this year further corroborated this, stating that only 14% saw an increase in productivity.

Phase One

These results can largely be attributed to the fact that those using bridging solutions had done the minimum to comply. Rather than looking at how processes would need to change to accommodate phase one and two compliance, many businesses looked for

solutions that would require them to make “minimal changes to their record keeping and accounting methods, using bridging software to link to their existing processes”, according to HMRC.

The tax authority said it hoped “these businesses may feel able to move to other software solutions [that]... will enable them to experience the wider benefits of MTD” over time. But what’s worrying is that our recent research of tax and finance professionals conducted with Taxation magazine in April suggested 60% intend to use the same technology to comply with phase two and so could continue to struggle to realise any benefits.

In contrast, those that embraced MTD compliance more wholeheartedly by adopting a “single, fully integrated software package” reported spending “less time overall dealing with their tax affairs” and a “reduction in input error”. Because information was entered only once, these businesses found it easier to manage the process, devoted less time to preparing the return, and were also able to spot and correct errors at source.

Our own market research revealed that many tax professionals believe automation can confer real operational benefits. Nearly half agreed that automating the VAT process would improve efficiency, a third thought it would reduce errors, and a quarter that it would improve data quality. A fifth believed it could also free up time, allowing them to work on more valuable tasks.

Spreadsheets in Decline

Following its evaluation of phase one, HMRC said it intended to develop “guidance to help businesses understand what they should consider when choosing software”. It’s a promise the tax authority has already made good upon, suggesting four roads the business can go down to ensure compliance with phase two, as we explain below.

Back in the early stages of the formulation of MTD, HMRC conceded to industry pressure and agreed to provide support for spreadsheet-based submissions. We saw this in phase one with the use of API-enabled spreadsheets, and spreadsheets can still be used to comply with the digital links mandate. Data can be transferred between spreadsheets using formulas or macros to link cells which is then submitted to HMRC via the API-enabled spreadsheet. But while this may be the least disruptive, it’s also one of the most problematic options.

Spreadsheets are prone to error through the misapplication of formulas, broken macros, or human mistakes. Spotting these errors and tracing them to source can be difficult and they often go unnoticed until a query comes back down the line. Ownership is also an issue, resulting in key man dependency with one small team or even one individual being responsible for the management of a growing barrage of spreadsheets. For these reasons, HMRC audits will typically focus first and foremost on spreadsheet testing because this where they’re likely to have the highest hit rate.

Despite the fact that spreadsheet software is



ubiquitous, its use is actually in decline under MTD. A survey by the Institute of Chartered Accountants in England and Wales (ICAEW) at the end of 2019 found a 47% decrease in spreadsheet use under phase one.

Alternative Compliance Choices

The second compliance option is the import/export or download/upload of data. This involves outputting transaction data from source data digital records into a digital format such as CSV. Files are then imported into the calculation spreadsheet or MTD software to form a compliant digital link. This approach has advantages in that it ensures data from disparate sources is aggregated and converted into a common format plus uploads can also be scheduled to ensure data remains timely. The downside is that there is no additional value. This method simply allows the data to be moved safely from one area to another but doesn't address the problems of checking for errors or carrying out calculations.

The third option involves automated data transfer whereby data is moved between two systems within the business. Source data is taken directly from accounting/ERP systems and uploaded into the integrated MTD software. This offers a number of advantages as the user can control the entire process and benefit from added functionality. It becomes possible to check for errors and anomalies at source,

and the prospect of penalties. To guard against this, it is advisable to be able to demonstrate compliance through a digital audit trail. This reveals where the links are and enables the business to show how and when changes were made and to trace transactions back to source.

Another consideration is the prospect of further regulatory change. The direction of travel globally is towards near or real-time reporting that will allow tax authorities to move compliance further upstream so that tax becomes more immediate and transparent. The UK government has already announced a ten-year plan for further regime change, with plans to extend the reach of MTD for VAT to all VAT customers from April 2022. It also confirmed that HMRC are looking at payment of tax at the point of sale, facilitated by an intermediary, for the payment of VAT. If requirements under MTD for VAT are increased, the MTD software needs to be able to accommodate these.

Long-tailed Compliance

MTD for VAT is therefore very much a long game which means businesses also need to think in similar timeframes. Rather than looking at short-term compliance, there's a need to adopt solutions that offer long-term compliance. Yet many of the solutions on the market don't appear to have been developed with this in mind. Back in March the ICAEW called for

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for instance. Plus, once the data is within the software it is possible to make amendments and adjustments without the need to step outside the process.

The final option is to use email or a portable device to send data. This enables spreadsheets containing digital records to be sent via email or a portable device such as a memory stick, flash drive etc to a recipient for import into MTD software. While this may sound convenient, it can be insecure because it risks data falling into the wrong hands. It also makes it difficult to keep track of and evidence compliance.

Proving Compliance

Proving compliance is an aspect few have considered when it comes to the second mandate. Phase two doesn't just signify the introduction of digital links, it also marks the end of the soft landing, or the period of the leniency HMRC has shown during the MTD process. Up until this point HMRC was simply looking for businesses to prove they had attempted to meet the requirements. Once the mandate comes into effect, businesses must meet them or face the consequences.

The onus will be on the business to prove its compliance. Any business deemed non-compliant faces the prospect of an investigation by HMRC, which sees the VAT repayment process put on hold,

a review of MTD software saying: "We are concerned that some of these products do not have a long-term commercial future and some do not incorporate the full range of functionality. MTD must be a proper and road-tested marathon and not a series of sprints".

The type of functionality the ICAEW hints at here is what HMRC originally envisaged for MTD. This was "nudges and prompts that will be incorporated into the MTD compatible software developed by third party software providers [to] help eliminate common errors, giving businesses greater certainty that they've got their tax right first time". These original objectives were watered down over time but the ICAEW makes a good point; there's no reason why MTD software can't offer this kind of functionality by flagging errors and using data analytics to look for patterns.

Assessing how the business needs to adapt today could well stand it in good stead for the future because MTD will also be extended beyond VAT. Trials for digitalising income tax have been under way for some time and the government mooted plans to consult on MTD for corporation tax this autumn as part of its ten year plan. Having the right processes in place today for MTD for VAT could well ensure the business is better placed to deal with the digitalisation of these other tax regimes as and when the time comes. **n**

